June 26, 2017

Chairman Bill Huizenga
Ranking Member Carolyn B. Maloney
House Financial Services Committee
Subcommittee on Capital Markets, Securities, and Investment
2129 Rayburn House Office Building
Washington, DC 20515

Re: Subcommittee Hearing, "U.S. Equity Market Structure Part I: A Review of the Evolution of Today's Equity Market Structure and How We Got Here."

Dear Chairman Huizenga and Ranking Member Maloney:

Thank you for holding this important hearing, "U.S. Equity Market Structure Part I: A Review of the Evolution of Today's Equity Market Structure and How We Got Here," and for the opportunity to offer suggestions on how to continue improving the US capital markets. We appreciate your focus on what's working well, and what isn't, in today's markets.

The purpose of this letter is to urge you to continue the critical, ongoing, bipartisan work towards modernizing oversight of the US capital markets. As we begin this discussion, it is important to note that the markets generally work well for most investors. However, over the past several years, high profile market disruptions and events, as well as troubling enforcement cases and press reports, have exposed some cracks in the foundation of our market structure.

In the attached Statement for the Record, we explore the issues and recommend a handful of updates and enhancements -- many of which are already under consideration by the SEC -- that could significantly improve market transparency, reduce risks to investors, and improve investors' execution quality.

We thank you again for holding this important hearing, and for the opportunity to submit the attached statement, which we ask be included in the hearing record. If you or your staff have any questions or comments, please feel free to contact me at (202) 909-6138.

Sincerely,

Tyler Gellasch
Executive Director

Statement of Tyler Gellasch, Executive Director of the Healthy Markets Association, before the House Financial Services Committee, Subcommittee on Capital Markets, Securities, and Investment

June 27, 2017

Chairman Huizenga, Ranking Member Maloney, and other members of the Subcommittee, thank you for holding this hearing, and for offering us the opportunity to provide this statement for the record.

As you begin your exploration of our markets, it is important to note that the markets generally work well for most investors. However, over the past several years, high profile market disruptions and events, as well as troubling enforcement cases and press reports, have exposed cracks in the foundation of our market structure.

A handful of updates and enhancements -- many of which are already under consideration by the SEC -- could significantly improve market transparency, reduce risks for investors, and improve investors' execution quality. Importantly, many of these enhancements require simply empowering investors with the information they need to make better, more informed decisions.

We appreciate your focus on identifying and working to address market participants' concerns. If the US capital markets are to remain the most robust, vibrant, and efficient in the world, improvements will need to be made. We thank you for working to do just that.

About Healthy Markets

The Healthy Markets Association is an investor-focused not-for-profit coalition working to educate market participants and promote data-driven reforms to market structure challenges.[1] Our members, who range from a few billion to hundreds of billions of dollars in assets under management, have come together behind one basic principle: Informed investors and policymakers are essential for healthy capital markets.

Since our launch in September 2015, we have become a leading voice for investors in the market structure debates. We have:

- Drafted dozens of unique reports and analyses regarding market structure and regulatory developments, including our industry-leading, monthly publication, "Market Structure Insights";
- Created two industry-leading "due diligence" questionnaires to assist investors and brokers in evaluating order routing practices and ATS risks; and

[1] Launched in 2015 by five leading buyside firms, Healthy Markets has since expanded to include nine buyside members and nine working group members. Prior to joining Healthy Markets as its first Executive Director, I served as Senior Counsel in the United States Senate, as well as Counsel to SEC Commissioner Stein. Prior to my government service, I practiced law in the field of securities regulation at leading law firms in New York City and Washington, DC. While in the US Senate, I worked as the lead staffer for several Senate Hearings and reports related to the US capital markets, including a post-Flash Crash hearing on the stability and integrity of the markets.

- Offered significant input to Congress, the Securities and Exchange Commission, and the SEC's Equity Market Structure Advisory Committee through dozens of meetings and comment letters.[2]

In the pages that follow, we offer a very brief overview of the past two decades of regulatory developments in US equities trading, and then highlight specific areas for potential improvement.

Background

The evolution of modern capital markets has been stunning in its speed and breadth. Order and execution information that was once communicated through hand signals and gruff voices now rockets around the world through laser beams, fiber optic cables, and microwave towers. Futures, equities, options, and other derivatives are traded seamlessly by computers in fractions of a second.[3] In the US equities markets, trading may now occur at any of several exchanges, several dozen dark pools, or hundreds of broker-dealer "internalizers." But it wasn't always this way.

For decades, trading in stocks was generally restricted to formally regulated exchanges dominated by a small handful of actors. Then, starting in the 1980s, following the Securities Act

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[2] For example, some of our relevant comments to the SEC and its Equity Market Structure Advisory Committee include:

- Statement of Healthy Markets Association Chairman Dave Lauer before the SEC Equity Market Structure Advisory Committee, May 11, 2015, *available at* https://www.sec.gov/comments/265-29/26529-15.pdf (re reforms to 611, 605, 606, market data costs, and other matters);
- Letter from Healthy Markets Association to SEC, Feb. 26, 2016, *available at* https://www.sec.gov/comments/s7-23-15/s72315-18.pdf (re reforms to ATSs' disclosures);
- Statement of Healthy Markets Association Director Chris Nagy before the SEC Equity Market Structure Advisory Committee, Aug. 2, 2016, *available at* https://www.sec.gov/comments/265-29/26529-80.pdf (re order routing disclosure reforms);
- Letter from Healthy Markets Association to SEC, Sept. 26, 2016, *available at* https://www.sec.gov/comments/s7-14-16/s71416-19.pdf (re order routing disclosure reforms);
- Letter from Healthy Markets Association to SEC, Dec. 23, 2016, *available at* https://www.sec.gov/comments/265-29/26529-1441899-130023.pdf (re access fee pilot);
- Letter from Healthy Markets Association to SEC, Jan. 6, 2017, *available at* https://www.sec.gov/comments/s7-14-16/s71416-1464340-130322.pdf (re order routing disclosure reforms); and
- Letter from the Healthy Markets Association to the SEC, Apr. 3, 2017, *available at* https://static1.squarespace.com/static/5576334ce4b0c2435131749b/t/58dfe79f1e5b6c817446e9b9/1491068831728/EMSACMtgLetter4-3-17.pdf (re priorities for SEC and EMSAC).

[3] While the hearing and the majority of this statement focus on the trading of US equities, we note that equities are just one asset type. In reality, equities, futures, and options are all inextricably linked. Perhaps the most infamous example of these connections was the May 6, 2010 "Flash Crash", in which unusual trading in the "E Mini" futures contract (traded on a futures exchange regulated by the CFTC) triggered a sell-off in the SPY (traded on equities exchanges regulated by the SEC), which itself triggered sell-offs in individual equities and options. See Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues, Sept. 30, 2010, *available at* https://www.sec.gov/news/studies/2010/marketevents-report.pdf.

Amendments of 1975[4], a host of new options began to emerge. These new trading venues have come to be called "alternative trading systems" or ATSs. Many large institutional investors have been drawn to dark pools over exchanges because dark pools may allow them to execute trades in larger sizes without tipping off predatory traders or significantly impacting market prices.[5]

The proliferation of these venues was driven, in part, as a result of frustrations with the perceived abuses of New York Stock Exchange specialists and traditionally high trading costs. Market participants and regulators alike sought to--and did--foster competition with the removal of NYSE Rule 390.

At first, there was extremely little regulatory oversight of these new execution venues. Then, in 1998, the SEC adopted Regulation ATS, which required all ATSs to be registered as broker-dealers, thus subjecting dark pools to FINRA oversight. As part of this process, all ATSs had to file basic disclosures with the SEC about their operations and meet other regulatory requirements.

As the SEC was beginning to regulate theses new market venues, they were also beginning to improve oversight on brokers' order routing decisions. As the number of venues proliferated, the decision of where (and how) to send an order to buy or sell stock into the market became increasingly important for investors and their brokers. Each execution venue has its own set of costs and benefits, both explicit and implicit. In 2000, the SEC adopted the forerunner to Rule 606 (Rule 11Ac1-6),[6] which was intended to inform brokers and investors about how brokers routed their orders.

We witnessed first hand the impact of the reports on competition and behavior in the marketplace.[7] The new disclosures promoted informed competition and aided in best execution. they allowed firms to examine their execution quality, and helped brokers compare themselves to their peers. They also gave investors information about how certain brokers generally routed orders. Investors and brokers changed behavior based on what they saw.

Unfortunately, those disclosure obligations for ATSs and order routing reports are nearly entirely obsolete. Much of this obsolescence is due to the fundamental changes in trading securities over the past two decades. There are more exchanges, more dark pools, and more ways to trade. Order handling practices and order types have changed. Time horizons have shrunk.

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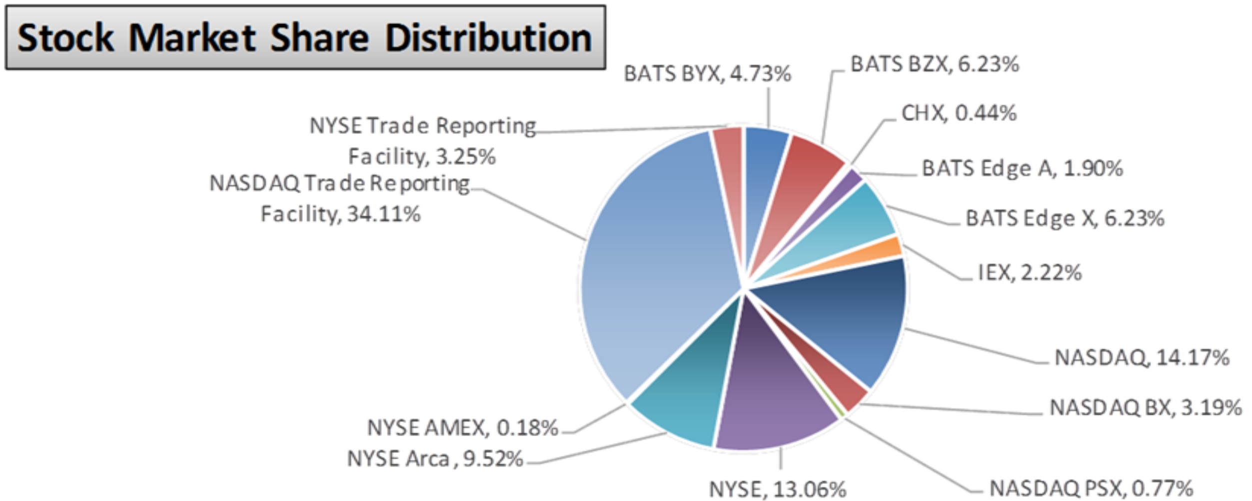
[4] Securities Acts Amendments of 1975, Pub. L. 94–29 (1975).

[5] As one finance professor commented to the SEC during its consideration of Regulation ATS, "Instinet began because institutions wanted an anonymous way to trade large blocks of stocks thereby minimizing information leakage." Letter from Daniel G. Weaver, Associate Professor of Finance, Baruch College, to Jonathan Katz, Secretary, Sec. and Exch. Comm'n, Nov. 23, 1998.

[6] Rule 11Ac1-6, which the SEC redesignated into Rule 606 in 2005, was first proposed by the SEC at the end of July 2000. 65 Fed. Reg. 48406 (Aug. 8, 2000).

[7] Chris Nagy, a Board Member for Healthy Markets, has been actively engaged with the SEC for decades, and his opinions on these issues are routinely sought by market participants and regulators. More recently, Mr. Nagy spoke with the SEC's Equity Market Structure Advisory Committee on August 2, 2016 about reforms to brokers' and venues' order routing disclosures.

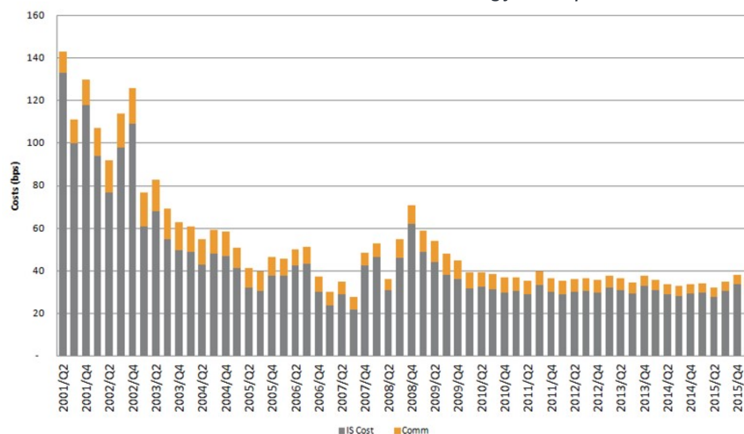
As the following chart demonstrates, trading volumes have also dramatically shifted away from being dominated by the two primary listing exchanges to being more readily split between the three major exchange families (Intercontinental Exchange's NYSE, Nasdaq, and CBOE's BATS), as well as a number of smaller exchanges and an increasing number of significant dark pools.



Somewhat surprisingly, despite the rise in competition amongst trading venues, and the dramatic decreases in explicit costs (e.g., commissions), the overall costs of trading haven't fallen that much. In fact, a study by ITG found that implementation costs for large block trades dwarf the commissions paid to brokers, as shown in the chart below.[8]

Implementation Shortfall and Commission Costs

Data as of December 31, 2015, Implementation Shortfall and Commission Costs for Large Cap Stocks in the USA
Source: Investment Technology Group



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[8] Meaningful trading analytics is significantly limited by the availability of comprehensive data. This block trading data, obtained from ITG, Inc., is referenced here to be illustrative of the relative weights of commissions versus other costs of trading (such as price movements immediately after trade execution). This reiterates the need for regulators to improve fairness and transparency in the markets by improving the collection and publication of meaningful order and execution statistics.

Thus, despite lower commissions in US equities trading, and robust competition amongst trading venues, the overall costs of trading have remained steady. Institutional investors, who have fiduciary duties to their customers, continue to look for ways to reduce these costs. Investment advisers are thus increasingly focused on their true and total costs of trading; the vast majority of which are likely these "implementation" costs--not just the commissions.

Unfortunately, despite imposing a legal obligation to protect their customers, the outdated regulatory regime does little to inform and empower investors seeking to meet their obligation. In the absence of many explicit regulatory protections or relevant disclosures, many institutional and retail investors have been left to question whether their brokers are routing orders to venues most likely to achieve the best fills, or instead sending their orders to the venues that maximize the brokers' profits. These concerns have been highlighted by academic research, press reports, recent regulatory actions, a best-selling book, and even Congressional hearings.[9]

Regulation NMS, which was adopted more than a decade ago, was a complex, comprehensive ruleset intended to foster competition amongst trading venues, while also protecting investors. Unfortunately, it has become wildly outdated, leaving significant opportunities for abuses and stability risks. After nearly a decade of inaction, in recent years regulators have begun to intervene with significant actions against several of the largest, most well-respected firms for market-structure-related abuses, including:

- Barclays,[10]
- Citadel,[11]
- ConvergEx,[12]
- Credit Suisse,[13]
- Deutsche Bank,[14]
- eBX, LLC (LeveL),[15]

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[9] See, e.g., *Conflicts of Interest, Investor Loss of Confidence, and High Speed Trading in U.S. Stock Markets*, before the U.S. Senate Permanent Subcomm. on Investigations, Comm. on Homeland Sec. and Gov't Affairs, (2014) (statements and video *available at* https://www.hsgac.senate.gov/subcommittees/investigations/hearings/conflicts-of-interest-investor-loss-of-confidence-and-high-speed-trading-in-us-stock-markets); see also *Computerized Trading Venues: What Should the Rules of the Road Be?*, Before the Subcomm. On Securities, Insurance, and Investment of the Senate Comm. on Banking, Housing, and Urban Affairs, (2012).

[10] In the Matter of Barclays Capital Inc., Exch. Act Rel. No. 34-77001 (Jan. 31, 2016), *available at* https://www.sec.gov/litigation/admin/2016/33-10010.pdf.

[11] In the Matter of Citadel Securities LLC, Exch. Act Rel. No. 34-79790 (Jan. 13, 2017), *available at* https://www.sec.gov/litigation/admin/2017/33-10280.pdf.

[12] In the Matter of G-Trade Services LLC, ConvergEx Global Markets Limited, and ConvergEx Execution Solutions LLC, Exch. Act Rel. No. 34-71128, (Dec. 18, 2013), *available at* https://www.sec.gov/litigation/admin/2013/34-71128.pdf.

[13] In the Matter of Credit Suisse Securities (USA) LLC, Exch. Act Rel. No. 34-77002 (Jan. 31, 2016), *available at* https://www.sec.gov/litigation/admin/2016/33-10013.pdf; see also In the Matter of Credit Suisse Securities (USA) LLC, Exch. Act Rel. No. 34-77003 (Jan. 31, 2016), *available at* https://www.sec.gov/litigation/admin/2016/33-10014.pdf.

[14] In the Matter of Deutsche Bank Securities Inc., Exch. Act Rel. No. 34-79576 (Dec. 16, 2016), *available at* https://www.sec.gov/litigation/admin/2016/33-10272.pdf.

- Goldman Sachs,[16]
- ITG,[17]
- Liquidnet,[18]
- Pipeline,[19] and
- UBS.[20]

Some of these firms were simply lax with their customers' confidential information. Others weren't protecting their customers in the ways they claimed or giving their customers the "best" prices. Others were offering secret advantages to favored trading firms. Still others were the very predatory traders whom they were purportedly protecting investors against.

In addition to these market integrity concerns, some market participants and investors have become increasingly concerned with overall market stability. As demonstrated by the May 6, 2010 "Flash Crash," the interconnections between futures (like the E-Mini futures contract), equities, options, and other derivatives, trading across numerous venues subjected to different regulatory regimes, open up opportunities for significant stability risks. Fortunately, since then, the SEC has led significant reforms that have dramatically reduced some of the risks of catastrophic spikes and collapses in asset prices. While these issues should not be overlooked (particular with respect to the interactions of ETFs and broad-based futures contracts), we nevertheless remain optimistic that the SEC's existing regulatory regime remains well-positioned to protect investors and the markets.

However, market integrity is still a significant concern. If Congress and the SEC are to ensure that the US equity markets remain the best in the world, a number of market structure reforms should be implemented.

Market Structure Reforms

Market participants all recognize the needs for some basic reforms. There is even significant consensus amongst many diverse market participants regarding the substance of most of the needed improvements. We urge Congress and the SEC to capitalize on those areas, and implement several critical enhancements.

In particular, we urge Congress and the SEC to work to focus on enhancing transparency and reducing conflicts of interests facing market participants. These efforts include:

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[15] In the Matter of eBX, LLC, Exch. Act Rel. No. 34-67969 (Oct. 3, 2012) (regarding the operations of LeveL).

[16] In re Goldman Sachs Execution & Clearing, L.P., Letter of Acceptance, Waiver, and Consent, No. 20110307615-01, (Jun. 3, 2014), *available at* http://disciplinaryactions.finra.org/Search/ViewDocument/36604.

[17] In the Matter of ITG, Inc. and AlterNet Securities, Inc., Exch. Act Rel. 34-75672 (Aug. 12, 2015), *available at* https://www.sec.gov/litigation/admin/2015/33-9887.pdf.

[18] In the Matter of Liquidnet, Inc., Exch. Act Rel. 34-72339 (June 6, 2014), *available at* https://www.sec.gov/litigation/admin/2014/33-9596.pdf.

[19] In the Matter of Pipeline Trading Systems LLC, Fred J. Federspiel, and Alfred R. Berkeley III, Exch. Act Rel. No. 34-65609 (Oct. 24, 2011), *available at* https://www.sec.gov/litigation/admin/2011/33-9271.pdf.

[20] In the Matter of UBS Securities LLC, Exch. Act. Rel. 34-74060 (Jan. 15, 2015), *available at* https://www.sec.gov/litigation/admin/2015/33-9697.pdf.

1. Finalizing enhancements to disclosures of order routing by brokers;
2. Significantly reducing or eliminating incentives that distort order routing behavior and pose conflicts of interest, including rebates and access fees;
3. Finalizing enhancements to disclosures by execution venues, and particularly Alternative Trading Systems (ATSs);
4. Reducing the use of, and significantly reform, NMS Plan structures; and
5. Offering clarity on reconciling disparate provisions between the US and Europe's MiFID II regime.

We also note that Congress and the Commission are currently being urged by some market participants and their advocates to eliminate certain provisions from Regulation NMS. In this regard, we urge caution. While we agree that some provisions within Regulation NMS (such as the Order Protection Rule) may lead to perverse and sub-optimal outcomes (particularly for orders of significant size, without a tailored block exemption), we also note that these protections serve an important purpose for both "retail" and institutional investors. The Order Protection Rule is one of the only explicit protections that investors have to force their brokers to demonstrate best execution. Put simply, it is the best execution backstop.

If these protections are reduced or eliminated, investors first need to have adequate safeguards in place to ensure: (1) brokers are still fulfilling their duties of best execution, (2) investors have the ability to verify that their brokers have fulfilled their legal obligation, and (3) investors have the ability to change their behavior in response to what they learn. Eliminating the Order Protection Rule and the prohibition on locked and crossed markets prior to adopting reforms to Rules 605, 606, and 610 would likely result in significant harm to investors. And even with enhanced disclosures, elimination of the Order Protection Rule without other reforms will likely shift significant burdens (and costs) onto buyside firms to ensure that they are receiving even reasonable quality executions.

Adopt Reforms to Order Routing Disclosures

Order routing disclosure obligations are well overdue. It's been 17 years since the SEC's order routing rules were first adopted, and nearly every element of them is no longer relevant. Trading isn't measured in seconds or minutes anymore; it's measured in microseconds.

At the same time, numerous regulatory enforcement actions and press reports have made it clear that some brokers' order routing practices have been disadvantaging their customers. Although specifics may differ between so-called "retail" and institutional investors, the overarching concern is the same. [21]

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[21] Healthy Markets generally objects to the characterization of "retail" investors as those who trade primarily through individual, often online brokers. As numerous studies have demonstrated, these individuals often have significantly greater wealth and financial resources than those who invest predominantly through institutional investment advisers. Thus, if policymakers and regulators are truly seeking to protect "mom and pop retail," it will ensure that its regulatory regime appropriately informs and empowers institutional investment advisers, like those who are members of Healthy Markets, who manage the bulk of savings and retirement assets.

Investors' orders are often routed in ways that may be worse for investors, but better for their brokers. In most cases, the investors will never know that their brokers' self-interested desire to avoid a fee, or collect a payment, or hit a pricing tier at a venue, resulted in a worse execution.[22]

Many institutional investors have invested years of effort and millions of dollars engaging in "self help." They have created or used significant "due diligence" questionnaires. In fact, our Members have directed us to help them identify and address concerns with brokers' order routing practices. The Healthy Markets Order Routing Transparency Initiative is a multi-pronged effort to do just that. These efforts have included:

- Development and publication of the Healthy Markets Order Routing Questionnaire to help investors make more informed broker selection decisions;
- Development of Order Routing Disclosure best practices and working with individual firms to improve disclosure practices;
- Development and publication of unique reports related to key issues impacting broker order routing practices; and
- Offering suggestions to regulators and the public, including through regulatory comment letters.

The Healthy Markets Order Routing Questionnaire, which was released in January 2017, is particularly informative.[23] This Questionnaire is a comprehensive list of more than 200 questions that can help investors better understand the practices and operations of their brokers. Again, none of this information is currently specifically required to be disclosed, yet much of it may be covered by reforms to Rule 606.

In addition to increasingly using questionnaires, institutional investors have developed extremely sophisticated trading strategies and analytical tools. Unfortunately, the efficacy of their efforts is nearly entirely dependent upon the voluntary cooperation of their service providers. As you might imagine, larger investors (with more order flow to leverage) are often able to enjoy more cooperation from their service providers. Even then, information provided is often incomplete and difficult to compare across different firms.

Last year, the Commission proposed reforming order handling disclosures, which would level the playing field for investors and shed significant light on many current practices.[24] This is an important effort, and Healthy Markets has offered extensive commentary on both the need for these reforms and potential further enhancements.[25]

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[22] Often, the data that would be required to accurately measure the quality of the execution is simply unavailable to the investors. Further, even in the rare instances that reasonable information may be available, investors (particularly those trading through online, discount brokers) may be unable to bring the comprehensive financial and personnel resources to bear that would be necessary to make sense of it. Worse, even if those two conditions are met, there is often limited recourse for an investor.

[23] The Healthy Markets Order Routing questionnaire is freely available to the public at: https://healthymarkets.org/order-routing-questionnaire.

[24] *Disclosure of Order Handling Information*, Securities and Exchange Commission, 81 Fed. Reg. 49432 (July 27, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-07-27/pdf/2016-16967.pdf.

[25] See, e.g., Statement of Healthy Markets Association Director Chris Nagy before the SEC Equity Market Structure Advisory Committee, Aug. 2, 2016, *available at* https://www.sec.gov/comments/265-29/26529-80.pdf; Letter from Healthy Markets Association to SEC, Sept. 26, 2016, *available at* https://www.sec.gov/comments/s7-14-16/s71416-19.pdf; and Letter from Healthy Markets Association to SEC, Jan. 6, 2017, *available at* https://www.sec.gov/comments/s7-14-16/s71416-1464340-130322.pdf.

Reduce Distortive Incentives, or at a Minimum, Adopt an Access Fee Pilot

As execution venues have proliferated, so have the various avenues for competition amongst them. Most notably, many execution venues have sought to compete on price, such as by offering rebates and different pricing tiers for customers. With different combinations, each venue may have dozens of different prices that could apply to different customers--none of which is readily apparent. At the same time, these incentives for trading typically accrue to the brokers--not the underlying investors on whose behalf the order is being placed.

As we have said before, this creates a

> fundamental conflict of interest for brokers looking to route their customers' orders. At its worst, a broker is incentivized to route an order to the venue that pays it the most (or costs the least), instead of the venue that that has the highest likelihood of execution fostering best execution for its customers.[26]

We are pleased at the growing consensus of market participants that have joined our longstanding calls for the elimination or significant reduction of rebates and other distortive incentives.[27] In large part because we believed the SEC was unlikely to aggressively limit these conflicts of interest, we and others have, for years, argued for the SEC to implement a pilot program to study the impact of this conflict of interest on investors.

Healthy Markets and the SEC's Equity Market Structure Advisory Committee have detailed proposals to implement such a study. While we might prefer Congress to direct the Commission to take more aggressive action, if the SEC chooses to conduct a formal study, we would urge the SEC to adopt a comprehensive pilot study without delay.[28] In addition to the thoughtful recommendations of the EMSAC, we would also urge the Commission to (1) directly propose the pilot program, and not use the NMS Plan process; (2) simplify the study as much as possible, while also including all relevant exchanges and ATSs; and (3) offer the Canadian regulators an opportunity to coordinate a similar effort.[29]

Reducing the myriad conflicts of interest facing brokers should be a key objective towards promoting more fair and efficient capital markets.

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[26] Letter from Healthy Markets Association to SEC, Dec. 23, 2016, *available at* https://www.sec.gov/comments/265-29/26529-1441899-130023.pdf (citing, *inter alia*, *Conflicts of Interest, Investor Loss of Confidence, and High Speed Trading in U.S. Stock Markets*, Hearing before the Permanent Subcommittee on Investigations, Committee on Homeland Security and Government Affairs, June 17, 2014, *video available at:* http://www.hsgac.senate.gov/subcommittees/investigations/hearings/conflicts-of-interest-investor-loss-of-confidence-and-high-speed-trading-in-us-stock-markets).

[27] See, e.g., Letter from SIFMA to SEC, Mar. 29, 2017.

[28] A simpler approach might be to run a pilot eliminating rebates.

[29] See Letter from Healthy Markets Association to SEC, Dec. 23, 2016, *available at* https://www.sec.gov/comments/265-29/26529-1441899-130023.pdf.

Adopt Reforms to Regulation ATS

Amidst a slew of regulatory enforcement actions against ATS operators, in November 2015, the SEC proposed significantly expanding and improving the disclosures required of ATSs that trade NMS stocks (NMS Stock ATSs).[30]

Investors and brokers now know that many of the oldest, largest, and most well-respected execution venues have broken the law.[31] Some of these infractions have been relatively minor, while others have consisted of the ATS operator deceptively acting as the very type of predatory trader that it was publicly arguing it was protecting its customers against.

Unfortunately, as the SEC recognized in its proposed reforms to Reg ATS, the current regulatory regime is woefully inadequate to empower investors and brokers with the information they need to reasonably protect themselves.

In fact, to help fill this void, the Healthy Markets Association's members have directed us to engage in our ATS Transparency Initiative, which is a multi-pronged effort to enhance ATS disclosure practices. Our work on this initiative has included:

- Development and publication of the Healthy Markets ATS Questionnaire to help investors and routing brokers make more informed venue selection decisions;
- Creation and distribution of the ATS Transparency Index™, which provides a unique system to help inform market participants of ATSs' transparency and disclosure practices;
- Creation and distribution of the 2016 ATS Risk Assessment, which provides comprehensive comparisons and analyses of 18 leading ATSs, on issues ranging from conflicts of interest to technology risks;
- Development of ATS disclosure best practices and working with individual ATSs to improve disclosure practices;
- Development and publication of unique reports related to key issues impacting ATSs, including the Dark Side of the Pools: What Investors Should Learn from Regulators' Actions; and
- Offering suggestions to regulators and the public regarding the regulation of ATSs, including through regulatory comment letters.

The Healthy Markets ATS Questionnaire, which we publicly released in September 2015, is particularly noteworthy.[32] That ATS Questionnaire arms investors and brokers with dozens of questions to ask their ATSs on issues ranging from technology to conflicts of interest to quantitative measurements of executions. Importantly, almost none of this information is currently explicitly required by Regulation ATS. Equally important, much of this information has been included in the Commission's proposed reforms to Regulation ATS.

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[30] Regulation of NMS Stock Alternative Trading Systems, 80 Fed. Reg. 80998 (Dec. 28, 2015) (the "Proposal").

[31] To date, regulators have settled cases against the operators of many of the leading equity ATSs, including Barclays, Convergex, Credit Suisse, Deutsche Bank, eBX (LeveL ATS), Goldman Sachs, ITG, Liquidnet, Pipeline, and UBS.

[32] The Healthy Markets ATS Questionnaire is freely available to the public at: https://www.healthymarkets.org/ats-questionnaire.

Nevertheless, as we articulated in our February 2016 comment letter,[33] we encourage the SEC to revise its proposal to:

- Expand the coverage to include ATSs beyond those that trade NMS stocks;
- Consider eliminating conflicts of interest by prohibiting an ATS operator or an affiliate from trading on a principal basis in the ATS, or at a minimum, on terms any different than unaffiliated third-parties;
- Expand reporting of order and trading metrics so that market participants may better evaluate venue performance and conflicts of interest; and
- Modernize and mandate Rule 605 disclosure for all NMS ATS operators separate and distinct from any affiliated broker-dealer.

Since the Commission proposed its Reg ATS reforms nearly 18 months ago, only more troubling practices have come to light. Unfortunately, investors and brokers looking to protect themselves have been left in the terrible position of being aware of problems, but also largely unable to address them.

We hope you will urge the SEC to adopt revised ATS reporting obligations on a bipartisan basis without delay.

Significantly Reduce the Use of NMS Plan Process and Reform NMS Plan Governance

We agree with the growing chorus of market participants and experts that argue that NMS Plan usage and governance deserves significant reforms, including through the direct inclusion of other market participants.

However, we believe that the NMS Plan process is deeply conflicted and outdated. Since it was first adopted, the self-regulatory organizations (SROs) have both proliferated in number and become for-profit entities. Conceptually, we are concerned any time the regulatory apparatus is outsourced to market participants whose financial interests may be in conflict with their regulatory responsibilities.

This concern is not just theoretical. The recent history with NMS Plans, particularly regarding the design and implementation of the Consolidated Audit Trail and the Tick Size Pilot, have been disappointing at best. Administratively, these plans are burdened with an incredible amount of process and frequent delays. Substantively, these plans also have tended to show a distinct bias towards the market participants involved in their creation and adoption (the SROs). For example, we find it puzzling how little of the costs of the CAT will be borne by the actual exchanges, and how much will be borne by the broker-dealer community.

Simply broadening participation to include more for-profit market participants (such as broker-dealers and investment advisers) may reduce concerns with the balance of the substantive results of NMS Plans, but may also lead to regulatory stagnation and generate even more conflicts of interest. It will almost assuredly not speed up or ease the administration of these plans, and will likely have the opposite effect.

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[33] Letter from Healthy Markets Association to SEC, Feb. 26, 2016, *available at* https://www.sec.gov/comments/s7-23-15/s72315-18.pdf.

We urge Congress to revisit the law creating this deeply flawed process. At the same time, we urge the SEC to reduce its outsourcing of its governmental responsibilities, and use the NMS Plan process infrequently. This would allow the SEC to avoid issues created merely by the conflicts of interest that plague the NMS Plans. In that vein, we were encouraged by then-Acting Chairman Piwowar's recent remarks that an Access Fee Pilot would be done as an SEC rule, and not as an NMS Plan.

Further, to the extent that the NMS Plan process is still utilized, we encourage the SEC to: (1) significantly modify the governance to include significant voting representation of other non SRO market participants, (2) increase transparency of market data costs, and (3) adopt measures to prevent deadlocks and undue delays. Without these measures, we fear that NMS Plans will continue to be examples of self-regulation at its worst: self-interested, conflicted, and slow.

Offer Clarity on Reconciliation of US and EU Obligations for Best Execution and Research Payments

In the US, investment advisers are statutorily permitted to pay for research using commission dollars, if certain criteria are met. For many asset managers, particularly small and mid-sized, active managers, this is a critical element to their ongoing business. At the same time, several very large US firms have sought—for more than a decade—to unbundle research and execution costs, and have been largely unsuccessful.

Some brokers who provide research have refused to accept cash payments for their research, while others have accepted cash payments or commission dollars.

Now, MiFID II in Europe, which becomes effective in January 2018, is pushing firms to use Research Payment Accounts or pay directly in hard dollars. This move is driving many firms to develop costly compliance regimes for research provision and payment, but also appears to be inconsistent with Section 28(e). Further, many investment advisers with US and European customers are being pressured to develop consistent policies and practices.

There are a number of thorny issues that could use regulatory input. For broker-dealers, just an acknowledgement that a cash payment may be permissible in some circumstances (i.e., broadening the no-action relief currently provided to some brokers) would resolve significant regulatory uncertainty. For investment advisers, guidance on trade and research allocations could be appropriate. For example, if a portfolio manager generates an order for one million shares of stock, and that order is to be allocated to two different funds, one subject to US rules while the other is subject to EU unbundling rules, how should the adviser allocate the trades, commission costs, and research costs? While splitting the clients into two groups may seem an easy and logical solution, this in practicality may present some challenges, as more often than not client orders are combined into blocks for purposes of seeking best execution and operational efficiency. A re-affirmation of Section 28(e), as well as guidance on compliance with the inconsistent regulatory regimes facing US firms (perhaps structured as a safe harbor) would be greatly appreciated.

Don't Leave Investors Without Order Protection

At its root, Regulation NMS is designed to protect investors through a combination of disclosures, obligations, and prohibitions. Put simply, the collective ruleset is intended to ensure that investors receive best execution. And the rules are designed to work together. For example, as our Chairman explained to the EMSAC in May 2015:

> Rule 611 sought to provide strong intermarket price protections and offer greater assurance on an order-by-order basis. Rules 605 and 606 were intended to supplement Rule 611 by providing transparency into execution quality and broker order routing, thereby empowering investors to make informed decisions based on quantitative metrics.[34]

The objective of Rule 611 is very clear: ensure investors get the best available prices. In fact, Rule 611 is one of the few protections that investors have in place which serves as a backstop on an order-by-order basis to ensure that they are receiving the best price in the market.[35]

Some market participants and their advocates are now asserting that Rule 611 should be eliminated. However, to support this argument, they have offered no specific evidence that Rule 611 has proven harmful on any grand scale, nor have we seen any specific evidence to support the assertion that it is the root cause of increased fragmentation and complexity in US markets. That said, we recognize that Rule 611, as it currently exists within the rest of Reg NMS, has several flaws and detractors.

Some have argued that Rule 611 may:

- Subsidize non-viable exchanges;
- Increase connectivity costs to the industry;[36]
- Create unnecessary complexity and intermediation, including the promotion of complex order types; and
- Maintain a one-size-fits-all market that has not served small- and mid-cap companies well.

We urge you to work with your fellow Commissioners and Commission staff to consider several refinements to Regulation NMS in addition to those identified above, including:

- Modernizing brokers' best execution obligations, including more quantitative analysis and more rigorous review of executions;
- Re-examining order handling and routing by exchanges generally, including a reexamination of complex order types; and
- Boldly exploring ideas to reduce distortive incentives, including rebates, access fees and the consolidation of multiple exchange subsidiaries.

If the Commission elects to adopt changes to Rule 611, we might consider shifting the responsibility of order protection on an order-by-order basis in Rule 611 from the exchanges back to the brokers and expanding its scope to provide protection to the displayed "depth-of-book."[37]

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[34] Statement of Healthy Markets Association Chairman Dave Lauer before the SEC Equity Market Structure Advisory Committee, May 11, 2015, *available at* https://www.sec.gov/comments/265-29/26529-15.pdf.

[35] Id.

[36] We note that these costs may also be up because of market venues' decisions to repeatedly increase their various data fees, which are rarely scrutinized or rejected, and the proliferation of venues.

[37] In its 2010 concept release, the Commission sought input on various provisions to promote displayed liquidity, such as expanding depth-of-book protections under Rule 611.

Rule 611 serves as an imperfect backstop to a broker's best execution obligation, by ensuring that an investor should not generally receive an execution outside the prevailing market. If the backstop is removed or weakened without the implementation of new protections, investors will be more at risk to their brokers' conflicts of interest. Brokers will remain incentivized to route orders for reasons other than best execution, but will have even less of a standard against which to measure their own obligations. Investors will remain largely unable to identify and police abuses. Put simply, removing Rule 611 now will harm investors.

This is not a theoretical concern; as data suggests, brokers are already making order routing decisions based on their own bottom lines, and not necessarily the execution quality received for their customers.[38] Currently, these practices are bound by Rule 611 to result in executions that are within the market prices. This acts as a practical limit to the number of trade-throughs which is what the Commission originally sought to reduce through the adoption of the rule. It caps the amount of losses an investor could suffer from a conflicted broker. If Rule 611 is removed or weakened, then those losses would not be easily identified and limited.

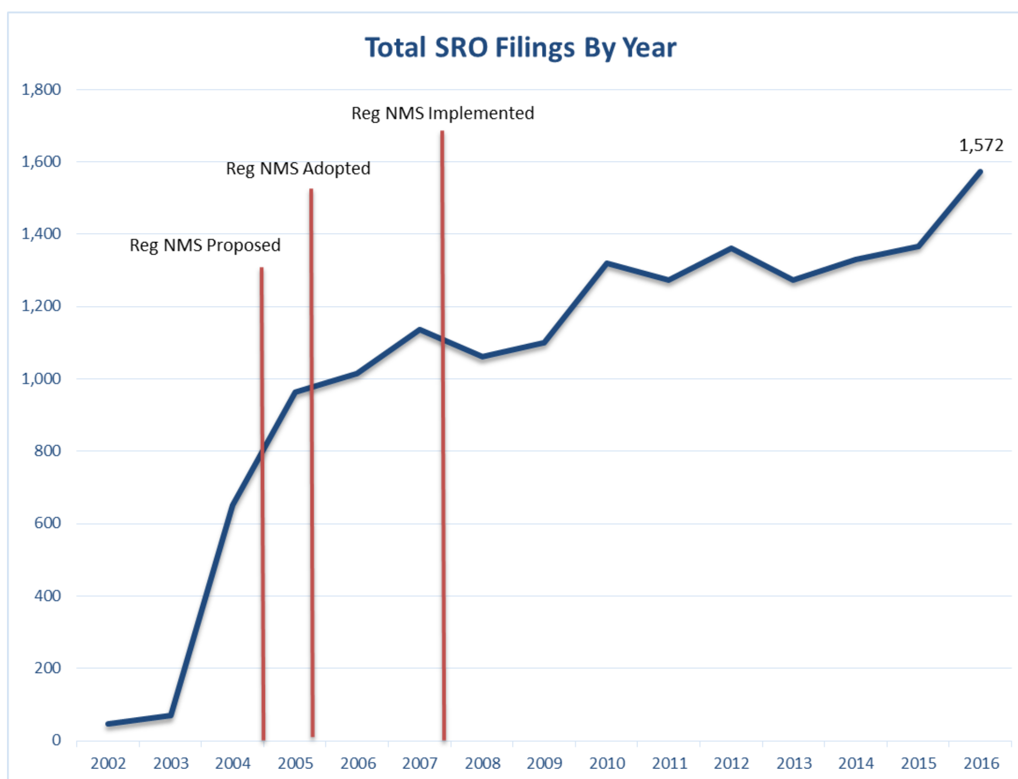
We urge Congress and the SEC to consider all of these issues and rules collectively, as modifications to one rule (such as the Order Protection Rule) could have significant ramifications on other key trading rules (such as best execution). In general, we support reducing conflicts of interest and distortionary incentives, while increasing transparency.

Exchange Filings, Fees, and Market Data Costs Keep Climbing

The process used by exchanges to set fees is also in need of reform to increase transparency and reduce conflicts of interest. Exchanges looking to change their rules or take other actions need to file their changes with the SEC. Unfortunately, this reasonable approach to increase transparency has led to an ever-rising flood of SRO rule filings.

The explosion of SRO filings over the last decade is best demonstrated in the following chart. Following the adoption of Regulation NMS, filings have increased at a steady pace each year, setting up 2017 to outpace 2016's number.

[38] For example, IEX currently occupies just 2% market share, despite consistently showing the lowest effective spread in the most symbols, as measured to the millisecond. For information on execution quality, please see "Execution Quality", BATS, *available at* http://www.bats.com/us/equities/market_statistics/execution_quality/ (last viewed Mar. 10, 2017). Similarly, TD Ameritrade has stated that it has consistently routed orders to the venues that pay it the most. Scott Patterson, *TD Ameritrade Executive Says Orders Go to Venues That Pay Highest Fees*, Wall St. Journal, June 17, 2014, *available at* https://www.wsj.com/articles/td-ameritrade-executive-says-orders-go-to-venues-that-pay-highest-fees-1403043559 (quoting TD Ameritrade testifying before Congress).



Market participants simply cannot keep up with them. Unfortunately, given the incredible volume, we also suspect that the SEC staff can't either. While some of these filings are relatively straight-forward, with easy-to-see implications, many are not. Many filings, such as filings related to order types and fees, may appear simple on their face, but may have extremely complex implications and impacts on not just the filing venues, but on other market participants. Unfortunately, given the sheer volume and the abridged time horizon within which the SEC is expected to respond, we suspect that many of these complexities are never explored.

By default, nearly all filings are approved. Most receive no comments.[39] Market participants (and, we suspect, the SEC staff) are simply overwhelmed.

As a result, two areas that have come to be key points of competition between the exchanges have led to a proliferation of complexities and expenses for market participants: order types and fees. The discussions regarding the proliferation of order types at market venues have gone on for years, spurred in part by SEC investigations and high-profile enforcement actions against market venues for creating predatory order types. Importantly, while the operators of many execution venues have professed a desire to eliminate some of this complexity, the order type complexity still abounds. This is further complicated by the interactions between different market venues. Unfortunately, this complexity makes it both likely for nefarious order types to exist, and also difficult for market participants or regulators to identify and stop manipulative or disruptive behavior.

[39] Less than 2% of the 1572 filings we reviewed in 2016 received comments.

Perhaps one of the greatest concerns for many market participants these days is the proliferation of market data and other fees. It's no secret that execution venues compete on price. As part of that ongoing competition, exchanges have developed complex tiered pricing regimes and market data fee structures. Collectively, these fee structures dramatically impact where orders are routed, and how much market participants pay.

On the other hand, one area that is not necessarily prone to competition is market data. And here's why: each exchange is a mini-monopoly. We believe the record on this point has been well-established by SIFMA and the NetCoalition in their ongoing dispute with the Commission.

Every routing broker and market maker, to be competitive, must have timely access to the broad spectrum of available information, including depth-of-book information from every major execution venue. In other words, no matter what the cost is, an institutional broker cannot simply "opt out" of paying the "voluntary" fee for more information faster, or his business will simply evaporate. He would be unable to provide adequate service to his customers, and would likely consistently provide lower-quality executions. He may even be violating his duty for best execution.

Exchanges are unquestionably aware of their unilateral monopoly pricing power over data fees. For example, NYSE has expanded its assertion of data control and fees in several different ways in recent years[40]. There are almost never any details explaining or justifying any fee increases[41].

At the same time, the SEC is tasked with ensuring the fees are "reasonable." While individual increases may not appear to be so egregious as to be facially unreasonable, collectively, the exchanges seem to have clearly crossed the blurry line. The Commission has allowed the exchanges to raise the fee temperatures to a boil, and other market participants, including both brokers and investors, are now being burned by the scalding fees.

Market data fees are little more than government mandated and government sanctioned monopolies for the now "for profit" exchanges. Market data fees are taxes on all market participants that the government has obligated market participants to pay and have remained unchanged since the adoption of the Securities Act Amendments of 1975. Meanwhile, exchanges have morphed from mutual entities to for-profit publicly traded companies. We urge Congress and the SEC to step in. The SEC must accept its role in approving the amount of these taxes and the frequency with which the rates change.

We urge the SEC to rapidly adopt a clear, public framework for evaluating any fee change proposals, particularly the "reasonableness" mandate of any fee increase, and if it fails to do so, for Congress to step in. Congress and the SEC should directly address the role regulations

[40] In April of 2017, NYSE introduced a revised Master User Agreement that implies that NYSE owns the data that brokers submit to it when they buy and sell stocks.

[41] For example, in May 2017 Nasdaq filed (Release No. 34-80808; File No. SR-GEMX-2017-20)to begin charging $1,250 per month, per computer port, for a specialized quote feed. In its filing, Nasdaq merely cites that it is in accordance with Section 6(b)(8) of the Exchange Act.

have played in creating the opportunity for exchanges to extract these significant monopolistic rents from market participants.

Caution on Certain Capital Formation Initiatives

Many companies, consultants, and other experts have observed the troubling decline in IPOs, as well as the increasing concentration of capital in some of the largest firms. We agree with many of these concerns.

However, some "solutions" to the reduction in new public securities and increased concentration seem to be focused on reducing costs and perceived burdens on public corporate issuers, or oddly, making it easier to raise capital and trade privately.

These solutions seem to ignore the comparative ease of raising private capital and the increasing tradability of restricted securities.[42] Also, none of these solutions address some of the structural advantages of larger firms (such as lower funding costs or access to advanced tax planning techniques). Ultimately, as long as firms can have multi-billion dollar valuations, thousands of shareholders, and even easy trading without ever being a "public" company, we think the current troubling trends will continue.

Unfortunately, further expanding the abilities of (1) companies to raise capital (particularly equity) outside of the registration process, and (2) shareholders to trade otherwise restricted securities may expose many investors to even greater risks and costs.

The benefits to investors of publicly traded securities are numerous. Public securities often are accompanied by more robust accounting and business disclosure practices. They also are far more easily and reliably valued--an area of particular interest recently. The liquidity risks and trading costs are often significantly lower than for similarly-situated private securities. Public securities are also much more easily benchmarked, such as against the S&P 500.

Thus, as you consider efforts to spur capital formation, we urge you to lean in favor of promoting more robust public markets. This will likely mean revising the contours of the numerous duplicative, overlapping and often nonsensical collections of exemptions from registration requirements of the Securities Act.

Finally, we urge caution in reforming requirements for public markets. As corporate issuers have increasingly turned to private capital and M&A activity, businesses, Congress, and regulators have increasingly sought to "restore balance" by removing some costs and burdens associated with public offerings or being a company with publicly traded securities. Some have even

[42] Elisabeth de Fontnay, The Deregulation of Private Capital and the Decline of the Public Company, 68 *Hastings Law Journal* 445-502 (2017), *available at* http://scholarship.law.duke.edu/faculty_scholarship/3741/.

proposed entirely different rules for trading shares for smaller public companies, from wider tick sizes to wholesale exemptions from Regulation NMS.

We are skeptical that these types of reforms will be effective at spurring additional IPOs or public securities. However, these efforts may negatively impact shareholders--deteriorating the quality of public offerings and the rights afforded shareholders in those offerings. We urge you to go in the opposite direction. We urge you to promote higher quality public markets with greater accountability, reliability, and price transparency.

Conclusion

Amidst growing concerns about the integrity and stability of the U.S. capital markets, market participants, experts, and policymakers have been clamoring to modernize disclosures and the basic ground rules for equities trading for years. If the US capital markets are to remain the best in the world, we urge you to work with investors and other market participants to implement some modest, but essential, reforms without delay.

Thank you for your consideration and for the opportunity to offer remarks at this important hearing.